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C O N F I D E N T I A L SECTION 01 OF 02 BRASILIA 000786

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TAGS: [ECON](#) [EFIN](#) [PGOV](#) [BR](#)

SUBJECT: BRAZIL'S FINANCE MINISTER: STEADY AS SHE GOES

REF: A. BRASILIA 613

[1B](#). BRASILIA 657

[1C](#). BRASILIA 776

Classified By: Economic Counselor Roman Wasilewski, Reasons 1.4 (b) and (d).

[11](#). (C) Summary: After weeks of intensifying criticism of the Lula administration's stringent fiscal line from within and without the government, seven hours of testimony to the Senate Economic Affairs Committee March 30. The hearing featured the unscheduled visit of Senate President Jose

[12](#). (SBU) GoB economic policy, in particular its strict adherence to the fiscal goal of a 4.25% of GDP primary surplus and the Central Bank's ultra-cautious stance on inflationary pressures, have come under ever broader sustained criticism for the last several weeks (Refs A and B). Even Vice-President Alencar has periodically joined the bandwagon, recently labeling the GoB's fiscal policy "irresponsible." Palocci nevertheless reaffirmed the GoB's unwavering commitment to the primary-surplus goal in March 30 Senate hearings, saying that this pillar of economic policy would be maintained if

[13](#). (U) The March 30 show of unity in the governing coalition reassured markets, with the Real appreciating against the dollar, the Sao Paulo

[14](#). (C) The GoB, by contrast, has not shaved its official growth projections, although its view of what sectors will lead GDP growth has changed. Planning Ministry chief economic advisor Miranda told Econoff March 24 that exports and investment will lead growth this year, which he still expects to come in about 3.5%. Previous predictions had been that pent-up consumer demand would spark consumption growth as interest rates can

[15](#). (SBU) The market turbulence that Brazilian investors are waiting out began after the Central Bank unexpectedly interrupted its cycle of interest rate cuts in January, citing inflationary pressures (Ref B). In this context, the March Central Bank decision to cut the baseline SELIC interest rate was notable not for its modest quarter-percentage-point size, but for the statement in the minutes of Central Bank's meeting, released March 25, that the Bank sees inflationary pressures easing. The first quarter inflation report, released March 31, reinforces the data on the easing of inflationary pressures and predicts consumer price inflation of 5.2% for the year, below the Central Bank's 5.5% target. Other hints of an improving economy may buy the GoB room for maneuver. Unemployment, for example, edged slightly lower in the latest national figures, while credit grew (

[16](#). (C) Comment. The public closing of coalition ranks behind Palocci at his March 30 committee hearings has provided some welcome reassurance. He also has had to use political capital to keep coalition partners in line, at a time when his government's popularity has slipped (ref C). If first- and second-quarter results fail to show positive developments with regard to GDP growth

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